90-741

No. ———

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ALETHA DEWSNUP,

Petitioner,

v.

LOUIS L. TIMM, JOHN NEIUWLAND and FLOYD M. CHILDS, Trustees of the UNITED PRECISION MACHINE AND ENGINEERING COMPANY PROFIT-SHARING TRUST, ABCO INSURANCE AGENCY, INC., and JOSEPH L. HENROID, as Trustee for the Annette Jacob Trust,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether Section 506(d) of the Bankruptcy Code enables a Chapter 7 debtor to void a lien on real property abandoned by the bankruptcy trustee to the extent that the lien exceeds the property's value.

PARTIES TO THE PROCEEDING

The parties to the proceedings in the court below were: Lamar and Aletha Dewsnup and Louis L. Timm, John Neiuwland and Floyd M. Childs, Trustees of the United Precision Machine and Engineering Company Profit-Sharing Trust; ABCO Insurance Agency, Inc.; and Joseph L. Henroid, as Trustee for the Annette Jacob Trust.

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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PETITION FOR A WRIT OF CERTIORARI

Aletha Dewsnup respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit (App., *infra*, at 1a-11a) is reported at 908 F.2d 588. The order of the United States District Court for the District of Utah, affirming the judgment of the bankruptcy court, is unreported (App., *infra*, at 12a-13a). The memorandum opinion of the United States Bankruptcy Court for the District of Utah (App.,

infra, at 16a-32a) is reported at 87 B.R. 676; its order of dismissal is unreported (App., *infra*, at 14a-15a).

JURISDICTION

The court of appeals entered its judgment on July 11, 1990. On September 20, 1990, this Court granted Petitioner's request for an extension of time to file her Petition for a Writ of Certiorari until November 8, 1990. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 506 of the Bankruptcy Code, 11 U.S.C. § 506, provides:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.
>
> (c) The trustee may recover from property securing an allowed secured claim the reasonable, ... es-

> sary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
>
> (i) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (ii) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a case under section 301, 302 or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case. . . .

Section 554 of the Bankruptcy Code, 11 U.S.C. § 554, provides in pertinent part:

> (a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate. . . .

Section 722 of the Bankruptcy Code, 11 U.S.C. § 722, provides in pertinent part:

> An individual debtor may . . . redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under Section 522 of this title or has been abandoned under Section 554 of this title, by paying the holder of such lien the amount of the allowed

secured claim of such holder that is secured by such lien.

STATEMENT

This case involves the question whether Section 506 of the Bankruptcy Code, 11 U.S.C. § 506, permits a debtor, who files a petition under Chapter 7 of the Code, to void a lien on abandoned real property to the extent that the lien exceeds the value of the property. The property in this case consists of two parcels of farmland in Utah that Petitioner Aletha Dewsnup and her now-deceased husband owned outright until 1978 (Record on Appeal ("ROA") 12, 44). On June 1, 1978, the Dewsnups mortgaged both parcels to respondents (*id.*). Respondents claim that they have a judgment lien on this property that secures an indebtedness now exceeding $140,000 (*id.* at 12-13, 44-45).

In June 1984, after two unsuccessful attempts at reorganization under Chapter 11 of the Bankruptcy Code, the Dewsnups commenced proceedings to liquidate their assets under Chapter 7 (ROA 45). Under the Bankruptcy Code's automatic stay provision, 11 U.S.C. § 362, the filing of the Dewsnups' petition stayed a foreclosure sale on their property. Because the Dewsnups believed that the amount of respondents' lien exceeded the fair market value of the mortgaged farm property, they sought to void a portion of the lien under Section 506 of the Bankruptcy Code (ROA 11-19). Section 506 provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . ." (11 U.S.C. § 506(a)); it further provides that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void. . . ." *Id.*, § 506(d).

In their Section 506 adversary proceeding, the Dewsnups requested the bankruptcy court (1) to determine the extent of the respondents' secured claim on the property and (2) to void the lien to the extent that respondents' claim exceeded the value of the property (App., *infra*, at 16a). The Dewsnups also sought to redeem the property by paying the respondents the fair market value of the property (*id.*). During these proceedings, the bankruptcy trustee apparently agreed that the value of the property was less than the lien and that unsecured creditors would realize nothing in a sale of the property; accordingly, the trustee abandoned the Dewsnups' property pursuant to Section 554 of the Bankruptcy Code because it was burdensome to the bankruptcy estate (*id.* at 3a n.2).

The bankruptcy court valued the Dewsnups' property at $39,000—substantially less than the over $140,000 claimed value of the respondents' lien—but declined to allow the Dewsnups to void the lien to the extent that it exceeded the property's value (App., *infra*, at 2a, 16a). The bankruptcy court held that Section 506(d) was inapplicable because it applies only to "property in which the estate has an interest" (*id.* at 24a, citing 11 U.S.C. § 506(a)); in the court's view, property that the estate has abandoned under Section 554 of the Bankruptcy Code "is no longer property of the estate and the estate, consequently, has no interest in the property" (App., *infra*, at 24a).

The district court summarily affirmed the bankruptcy court's decision (App., *infra*, at 12a-13a) and, on appeal, the Tenth Circuit affirmed in turn (*id.* at 1a-11a). The court of appeals initially noted that the "courts are clearly divided" on the question whether a Chapter 7 debtor can void the undersecured portion of a lien on abandoned real property under Section 506(d) and that a majority of courts, including the Third Circuit in *Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d 1304 (3d Cir. 1989), had held that a debtor can do so (App., *infra*, at 3a). The Tenth Circuit nonetheless expressly "reject[ed] the analysis of the Third Circuit in

Gaglia" (*id.* at 4a) and joined those courts that had declined to permit debtors to void undersecured liens on abandoned real property under Section 506(d) (*id.* at 3a).

In reaching this result, the Tenth Circuit agreed with the bankruptcy court that Section 506(a) applies only to "property in which the estate has an interest" (App., *infra*, at 5a-6a). The court concluded that the trustee's abandonment of the property meant that the estate no longer had an "interest" in the property and that Section 506(d) was inapplicable (*id.* at 6a-8a). The court of appeals also reasoned that allowing Chapter 7 debtors to use Section 506(d) to retain abandoned property (1) undercuts Congress' preference for reorganization rather than liquidation by allowing debtors to receive "more in liquidation than they would receive in a reorganization" (*id.* at 8a-9a); and (2) somehow converts Section 506(d) into a redemption provision, even though Congress had expressly provided only for the redemption of personal, not real, property in Section 722 (*id.* at 9a-10a). Finally, the court of appeals concluded that allowing lien avoidance under Section 506(d) unfairly deprives creditors of any post-petition appreciation in property and gives debtors "much more than the 'fresh start' to which they are entitled" (*id.* at 10a-11a).

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CONFLICTS WITH THE MAJORITY OF FEDERAL COURT DECISIONS CONSTRUING SECTION 506(d) OF THE BANKRUPTCY CODE

The court below recognized that its decision was in direct conflict with the Third Circuit's decision in *Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d 1304 (3d Cir. 1990), but rejected the holding and the analysis of that court (App., *infra*, at 3a-4a). In *Gaglia*, the Third Circuit concluded that Section 506(d) provides for lien avoidance on all "property in which the estate has an interest" (11 U.S.C. § 506(a)) and that such property broadly includes property, like abandoned property, that the estate does not administer in bankruptcy proceedings. 889 F.2d at 1307-08. Contrary to the Tenth Circuit, therefore, the Third Circuit held that that the plain language of Section 506(d) permits debtors to void the unsecured portion of creditors' liens on real property to the extent that those liens exceed the property's value, even if the estate has abandoned the property. *Id.*

The court below likewise acknowledged that "two other circuits . . . have recognized a debtor's ability to void liens under section 506(d)" but declined to follow them (App., *infra*, at 3a, citing *In re Folendore*, 862 F.2d 1537, 1539 (11th Cir. 1989) and *In re Lindsey*, 823 F.2d 189, 191 (7th Cir. 1987)). In *Folendore*, the Eleventh Circuit stated that the "plain language" of Section 506(d) allows a Chapter 7 debtor to void the unsecured portion of a lien on real and personal property. 862 F.2d at 1539. The Seventh Circuit in *Lindsey* likewise recognized that Chapter 7 debtors can "strip-down" liens under Section 506(d) to the extent that they exceed the value of abandoned real property. 823 F.2d at 190-91.

An even broader conflict has developed in the bankruptcy courts, which are divided concerning the applicability of Section 506(d)'s lien avoidance provision to real property in Chapter 7 proceedings. Eighteen bankruptcy courts have held that Chapter 7 debtors can void the undersecured portions of real property liens under Section 506(d). *See In re Kostecky*, 111 B.R. 823 (Bankr. D. Minn. 1990); *In re Donahue*, 110 B.R. 41 (Bankr. D. Kan. 1990); *In re Moses*, 110 B.R. 962 (Bankr. N.D. Okla. 1990); *In re Zobenica*, 109 B.R. 814 (Bankr. W.D. Tenn. 1990); *In re Zlogar*, 101 B.R. 1 (Bankr. N.D. Ill. 1989); *In re Hunter*, 101 B.R. 294 (Bankr. S.D. Ala. 1989); *United States v. Garnett*, 99 B.R. 757 (W.D. Ky. 1989), *aff'g*, 88 B.R. 123 (Bankr. W.D. Ky. 1988); *In re Crouch*, 76 B.R. 91 (Bankr. W.D. Va. 1987); *In re O'Leary*, 75 B.R. 881 (Bankr. D. Ore. 1987); *In re Worrell*, 67 B.R. 16 (C.D. Ill. 1986); *In re Cleveringa*, 52 B.R. 56 (Bankr. N.D. Iowa 1985); *In re Lyons*, 46 B.R. 604 (Bankr. N.D. Ill. 1985); *In re Gibbs*, 44 B.R. 475 (Bankr. D. Minn. 1984); *In re Bracken*, 35 B.R. 84 (Bankr. E.D. Pa. 1983); *Brace v. State Farm Mutual Automobile Ins. Co.*, 33 B.R. 91 (Bankr. S.D. Ohio 1983); *In re Vigne*, 18 B.R. 946 (Bankr. W.D. Pa. 1982); *In re Tanner*, 14 B.R. 933 (Bankr. W.D. Pa. 1981); *In re Lindsey*, 64 B.R. 19 (C.D. Ill. 1986).

In contrast, thirteen bankruptcy courts have reached a contrary conclusion, holding that Section 506(d) is inapplicable to real property liens in Chapter 7 proceedings generally, or at least in those proceedings involving abandoned real property. *See In re Mammoser*, 115 B.R. 758 (Bankr. W.D.N.Y. 1990); *In re Israel*, 112 B.R. 481 (Bankr. D. Conn. 1990); *In re D'Angona*, 107 B.R. 448 (Bankr. D. Conn. 1989); *In re Doty*, 104 B.R. 133 (Bankr. S.D. Iowa 1989); *In re Larson*, 99 B.R. 1 (Bankr. D. Alaska 1989); *In re Shrum*, 98 B.R. 995 (Bankr. W.D. Okla. 1989); *In re Hoyt*, 93 B.R. 540 (Bankr. S.D. Iowa); *In re McLaughlin*, 92 B.R. 913

(Bankr. S.D. Cal. 1988); *In re Smith*, 79 B.R. 650 (Bankr. D. Md. 1987); *In re Maitland*, 61 B.R. 130 (Bankr. E.D. Va. 1986); *In re Sloan*, 56 B.R. 726 (Bankr. D. Colo. 1986); *In re Cordes*, 37 B.R. 582 (Bankr. C.D. Cal. 1984); *In re Mahaner*, 34 B.R. 308 (Bankr. W.D. N.Y. 1983).

The decision below is, moreover, contrary to the leading treatise on bankruptcy law. In *Collier on Bankruptcy*, the author recognizes the conflict concerning whether Section 506(d) applies to real property in Chapter 7 proceedings, but explains that the minority position, holding that Section 506(d) is not applicable in such circumstances, "is directly contrary to the clear language of section 506(d) and the majority of cases which have considered the matter." 3 *Collier on Bankruptcy*, ¶ 506.07, at 506-75 (15th ed. 1989). Other authors have analyzed this conflict, reaching divergent opinions on the proper interpretation of Section 506(d).[1]

This substantial conflict concerning the scope of Section 506(d) warrants this Court's review.

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[1] *See* Note, *In Rem Lien Avoidance in Chapter 7: Lenders Beware*, 7 Bankr. Dev. J. 155, 172-73 (1990) (reviewing divergence of opinion on applicability of Section 506(d) to real property); Note, *The Debtor's Right to Restrict Lienholder Recovery to the Value of the Encumbered Property under Section 506 of the Bankruptcy Code*, J. Corp. L. 433, 434 (Spring 1986) (reviewing split in authority and endorsing majority view that Section 506(d) is available to Chapter 7 debtors seeking to void undersecured liens on real property); Note, *Can a Debtor Void a Lien on Real Property That Exceeds the Value of the Collateral?: An Interpretation of Section 506(d) of the Bankruptcy Code*, 45 Wash. & Lee L. Rev. 1393, 1410-11 (1988) (reviewing split in authority and endorsing minority view that Section 506(d) does not allow Chapter 7 debtors to void real property liens).

II. THE DECISION BELOW IS CONTRARY TO THE PLAIN LANGUAGE OF SECTION 506(d) OF THE BANKRUPTCY CODE

It is quite clear that the court below erred in construing Section 506(d), contrary to its plain words, to preclude Chapter 7 debtors from voiding liens on abandoned real property to the extent that they exceed the property's value. This Court has recently noted, in another case involving Section 506, that "[t]he task of resolving the dispute over the meaning of § 506[] begins where all such inquiries must begin: with the language of the statute itself." *United States v. Ron Pair Enterprises*, 109 S. Ct. 1026, 1030 (1989).[2] That inquiry highlights the court of appeals' error in this case.

Section 506 "governs the definition and treatment of secured claims, *i.e.*, claims by creditors against the estate that are secured by a lien on property in which the estate has an interest." *United States v. Ron Pair Enterprises*, 109 S. Ct. at 1029. Subsection (a) provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim" (11 U.S.C. § 506(a)); this means, in this Court's words, that "a claim is secured only to the extent of the value of the property on which the lien is fixed." *United States v. Ron Pair Enterprises*, 109 S. Ct. at 1029. Subsection (d), in turn, provides that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void. . . ." 11 U.S.C. § 506(d). Nothing in

[2] In *Ron Pair*, this Court held that the plain language of Section 506(b) of the Bankruptcy Code entitles creditors to post-petition interest on nonconsensual, oversecured allowed claims. 109 S. Ct. at 1030-31.

the plain language of Section 506(d) or this Court's description of the provision suggests that Section 506(d) is inapplicable to real property, much less abandoned real property.[3]

The Tenth Circuit refused to apply Section 506 on the ground that Section 506 is inapplicable to property that the estate has abandoned under Section 554 because abandoned property ceases to be "property of the estate" (App., *infra*, at 5a-6a). But Section 506 does not confine its scope to "property of the estate"; rather, it more broadly encompasses all "property in which the estate has an interest." 11 U.S.C. § 506(a). Though undefined in the statute, this latter phrase logically includes both "property of the estate" (11 U.S.C. § 541) *and* property, like property abandoned under Section 554, that is of interest to the estate, but is not technically "property of the estate." *See Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d at 1307-08; *In re Gibbs*, 44 B.R. at 478-79; *cf. In re Shrum*, 98 B.R. 995, 1001 (Bankr. W. D. Okla. 1989) (noting that Chapter 12 and 13 debtors often propose plans that deal with abandoned or exempted property even though such property is not "property of the estate," in that the property is still property in which the estate has an interest). This distinction is not inadvertent. Congress considered, but rejected, an early version of Section 506 that limited the provision to "property of the estate"—opting instead for the broader language in the statute as enacted.[4]

[3] This subsection states only two limitations on voiding liens under Section 506, neither of which is relevant here: it makes clear that the undersecured portions of liens are not void if (1) the underlying claim is disallowed only under Section 502(b)(5) or Section 502(e), which deal with unmatured debt and co-debtor claims, or (2) the claim is not an allowed secured claim due only to the creditor's failure to file a proof of claim. 11 U.S.C. § 506(d)(1-2).

[4] *Compare* 11 U.S.C. § 506(a) *with* H.R. 6, 95th Cong., 1st Sess. § 506(a) (1977) ("An allowed claim of a creditor secured by a lien on *property of the estate* is a secured claim to the extent of

The Tenth Circuit itself has implicitly recognized that the estate has an "interest" in abandoned property; it effectively conceded that Section 506 applies to certain items of *personal* property that the debtor may redeem under Section 722 of the Code after voiding an excess lien (App., *infra*, at 9a-10a).[5] But, in an exercise of tortured reasoning, the Court found in Section 722 a justification for its refusal to apply Section 506(d) to abandoned real property; it concluded that Section 722's " 'exclusion of real property . . . and its express limitation to specific tangible personal property [make it] obvious that Congress did not intend to permit a debtor to redeem his real property through the use of § 506(d)' " (App., *infra*, at 9a-10a; citation omitted).[6]

The court below has, however, misunderstood the Code and confused the concepts of lien avoidance and redemption. Section 506(d) voids liens on both real and personal property. It is not a redemption provision. The specific redemption provision of Section 722 exists because Congress perceived a need to prevent abuses peculiar to consumer credit arrangements by enacting a redemption mechanism for personal property that "is broader than rights of redemption under the Uniform Commercial Code." *See* H.R. No. 595, 95th Cong., 1st Sess. 380-81 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6336. This simply does not demonstrate that Congress intended to deprive Chapter 7 debtors of the right

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the value of such creditor's interest in such property . . ."), *quoted in* 3 *Collier on Bankruptcy*, ¶ 506.03, at 506-7) (emphasis added).

[5] Section 722 expressly applies to abandoned property (*see* 11 U.S.C. § 722), and its operation is dependent on lien valuation and avoidance under Section 506. *See* 4 *Collier on Bankruptcy* 722.05, at 722-7 (15th ed. 1989).

[6] In this portion of its opinion, the court of appeals may have stated an even broader holding: that Section 506(d) does not apply at all to real property in Chapter 7 proceedings, regardless of whether the estate has abandoned the property.

to void liens on real property under Section 506(d) and to redeem that property pursuant to state law.[7]

Indeed, Section 506(d), like the many other protections that Congress enacted in 1978, is critical to the debtor's "fresh start" under Chapter 7. *In re Folendore*, 862 F.2d at 1540. In many cases, application of Section 506(d)'s avoidance provision will enable debtors to retain possession of their property without having to pay off liens that far exceed the value of the property. With reduced (and realistic) liens, some debtors may be able to redeem their property outright from secured creditors, as petitioner seeks to do here; other debtors may be able to negotiate a repayment schedule with those creditors based on the reduced amount of the lien. *See Gaglia v. Federal Savings & Loan Ass'n*, 889 F.2d at 1308. While Section 506(d) protects creditors to the extent that they hold secured claims against the debtor's property—they will, after all, receive the value of the property through liquidation, redemption or negotiated repayment—it thus prevents erosion of one of the Bankruptcy Code's central purposes: avoiding impairment of the debtor's "fresh start" through post-bankruptcy foreclosures and deficiency judgments. *Id.* at 1308-09.

III. THE PROPER INTERPRETATION OF SECTION 506(d) OF THE BANKRUPTCY CODE IS AN IMPORTANT AND RECURRENT ISSUE

This case presents an important, and frequently recurring, issue concerning the proper interpretation of the Bankruptcy Code. Despite the enormous amount of litigation arising under Section 506(d)—evidenced by the over 30 reported decisions on this issue (*see* discussion,

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[7] The Tenth Circuit's suggestion that Section 506(d) should somehow not apply in Chapter 7 liquidations, but only in reorganizations under Chapters 11, 12 and 13, is equally difficult to fathom (App., *infra*, at 8a-9a). Nothing on the face of Section 506(d) limits it in this manner, and it is essential that it apply in Chapter 7 proceedings if Section 722 is to have any meaning.

supra, at 7-8)—the courts have been unable to reach a consensus concerning the proper interpretation of Section 506(d). This confusion threatens the uniform administration of the Bankruptcy Code and, absent this Court's review, will continue to spawn patchwork results in federal bankruptcy proceedings.

Resolution of the issue presented in this case—whether Section 506(d) of the Bankruptcy Code enables a Chapter 7 debtor to void a lien on abandoned real property to the extent that the lien exceeds the property's value—is vital to debtors and creditors who seek protection under the Bankruptcy Code. Bankruptcies are not uncommon. As of June 30, 1989, nearly 880,000 bankruptcy cases were pending in the federal courts; in 1989 alone, nearly 650,000 new bankruptcy cases—including almost 420,000 individual Chapter 7 cases—were filed in the federal courts. *See Reports of the Proceedings of the Judicial Conference of the United States, Annual Report of the Director of the Administrative Office of the United States Courts* (1989), Tables F & F-2, at 358, 362. Though precise statistics are unavailable, many of these proceedings involve farmer bankruptcies. As one commentator has noted, "the indebtedness of American agriculture . . . assumed drastic proportions" in the early 1980s, as land values declined, interest rates rose and commodity prices dropped, and pushed many farmers into bankruptcy. Grossman, *Troubled Times: The Farm Debtor Under the Amended Bankruptcy Code*, 38 Okla. L. Rev. 579, 581-82 (1985). In the current economic climate, the number of bankruptcies—including the number of farm bankruptcies—is unlikely to decline.

Disputes over the availability of Section 506(d) to Chapter 7 debtors will, therefore, predictably recur with some frequency. While not all bankruptcies involve adversary proceedings to void liens on real property under Section 506(d), the numerous published cases on this issue suggest that many do (*see* discussion, *supra*, at

7-8). Only this Court can provide the urgently-needed guidance to the federal courts concerning the proper interpretation of Section 506(d).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

TIMOTHY B. DYK
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November 8, 1990

APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 89-4067

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors,

LAMAR DEWSNUP,
Plaintiff,

ALETHA DEWSNUP,
Plaintiff-Appellant,

v.

LOUIS L. TIMM, *et al.*,
Defendants-Appellees.

Appeal from the United States District Court
for the District of Utah
(D.C. No. 88-C-0841G)

[Filed July 11, 1990]

Submitted on the briefs:

William Thomas Thurman and Scott C. Pierce, of McKay, Burton & Thurman, Salt Lake City, Utah, for Plaintiffs-Appellants.

Michael Z. Hayes, of Mazuran, Verhaaren & Hayes, P.C., Salt Lake City, Utah, for Defendants-Appellees.

Before ANDERSON, BARRETT, and BALDOCK, Circuit Judges.

PER CURIAM.

The issue presented in this appeal is whether a Chapter 7 debtor may use 11 U.S.C. § 506(d) of the Bankruptcy Code to void the undersecured portion of a lien on real property which has been abandoned by the bankruptcy estate.[1]

Facts

Debtors Aletha and Lamar Dewsnup filed a Chapter 7 bankruptcy petition in 1984. Within that case, they commenced this adversary proceeding to determine the validity and extent of a note and trust deed held on real property they own in Millard County, Utah. The two parcels of land are used for farming and are not the debtors' primary residence. The various appellees are the secured creditors of the property.

At the trial of this matter, debtors argued they could use section 506(d) to redeem this property. Specifically, they asserted this section allows them to void creditors' liens to the extent they exceed the fair market value of the parcels. At the time of trial, the bankruptcy court valued the land at $39,000. The note and trust deed held by creditors are far in excess of that amount. Debtors assert section 506(d) allows them to fully redeem the

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[1] After examining the briefs and appellate record, this panel has determined unanimously that oral argument would not materially assist the determination of this appeal. *See* Fed. R. App. P. 34(a); 10th Cir. R. 34.1.9. The case is therefore ordered submitted without oral argument.

property by tendering the assessed market value to creditors in cash. Although it was not entirely clear at the time of trial, the bankruptcy trustee has abandoned this property pursuant to 11 U.S.C. § 554(a).[2]

The bankruptcy court dismissed debtors' argument, holding section 506(d) was not intended to be used in this manner. *See In re Dewnsnup*, 87 Bankr. 676, 683 (Bankr. D. Utah 1988). The district court affirmed. On appeal, debtors urge this court to reject the bankruptcy court's reasoning and join the majority of courts which have allowed avoidance under section 506(d).

Discussion

Although courts are clearly divided on this issue, a majority have adopted the position which debtors urge. *See In re Gaglia*, 889 F.2d 1304, 1306-11 (3d Cir. 1989); *In re Brouse*, 110 Bankr. 539, 541 (Bankr. D. Colo. 1990); *In re Moses*, 110 Bankr. 962, 963-64 (Bankr. N.D. Okla. 1990); *In re Zlogar* 101 Bankr. 1, 7 (Bankr. N.D. Ill. 1989); *In re Tanner*, 14 Bankr. 933, 939 (Bankr. W.D. Pa. 1981). Included within this majority is the Third Circuit, which is the only circuit court to specifically address this issue. *See Gaglia*, 889 F.2d at 1306. Two other circuit courts have addressed questions which are tangentially related, and have recognized a debtor's ability to void liens under section 506(d). *See In re Folendore*, 862 F.2d 1537, 1539 (11th Cir. 1989); *In re Lindsey*, 823 F.2d 189, 191 (7th Cir. 1987).

However, a strong minority of courts have rejected this approach, concluding it is inconsistent with the in-

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[2] In the district court there was some question whether the property was abandoned by the trustee. However, in their brief to this court, debtors admit that the property was abandoned following the 1988 trial of this adversary proceeding. Appellant's Brief at 3; *see also In re Dewsnup*, 87 Bankr. 676, 677 n.1 (Bankr. D. Utah 1988) (for purpose of the bankruptcy court decision, court assumed the property was abandoned).

tended purpose of the section and is unfair to lienholders. *See In re Shrum*, 98 Bankr. 995, 1002 (Bankr. W.D. Okla. 1989); *In re McLaughlin*, 92 Bankr. 913, 915 (Bankr. S.D. Cal. 1988); *Dewsnup*, 87 Bankr. at 683; *In re Maitland*, 61 Bankr. 130, 134-35 (Bankr. E.D. Va. 1986).

Courts denying relief under this section have stated various reasons for doing so, including: 1) that abandoned property is not administered by the estate and therefore sections 506(a) and (d) have no application; 2) that allowing this relief inequitably gives debtors more in a Chapter 7 liquidation than they would receive in the reorganization chapters; and finally, 3) that allowing avoidance pursuant to section 506(d) renders the redemption provision found in Code section 722 meaningless. Because we agree with the district court's sound reasoning in this case, we reject the analysis of the Third Circuit in *Gaglia* and affirm.

Code sections 506(a) and (d) provide the starting point for our analysis. Those sections state:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> . . . .

> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless—
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506(a) and (d).

These sections were included in the Code to govern the definition and treatment of secured claims. *United States v. Ron Pair Enters., Inc.*, 109 S. Ct. 1026, 1029 (1989). Application of subsection (a) results in a bifurcation of previously secured claims. It provides that a claim is secured only to the extent of the value of the property which serves as collateral. The remainder of the claim, up to the amount of the original obligation, is unsecured. *Id.*; *see also* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 5, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6312.

In interpreting these provisions, we begin by recognizing, as the bankruptcy court did, that the trustee abandoned this property pursuant to section 554 of the Code. That section allows abandonment of property that "is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a). Property abandoned under this section ceases to be part of the estate. *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 5, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6299. ("Property ceases to be property of the estate, such as by sale, abandonment, or exemption."). It reverts to the debtor and stands as if no bankruptcy petition was filed. *See Brown v. O'Keefe*, 300 U.S. 598, 602 (1937); *Wallace v. Lawrence Warehouse Co.*, 338 F.2d 392, 394 n.1 (9th Cir. 1964); *Dewsnup*, 87 Bankr. at 681. Following abandonment, "whoever had the pos-

sessory right to the property at the filing of bankruptcy again reacquires that right." *Dewsnup*, 87 Bankr. at 681. Abandoned property is *not* property administered by the estate. Recognition of this principle is essential in considering whether debtors may void these liens.

Pursuant to the plain language of section 506(a), an allowed claim of a creditor is one in *which the estate has an interest.* It is "a secured claim to the extent of the value of such creditor's interest *in the estate's interest* in such property. . . ." Here, debtors argue that because an allowed secured claim is limited to the value of the collateral under 506(a), they may completely redeem the property and retain possession by paying creditors the property's fair market value.

This analysis overlooks the fundamental premise of the language contained in this section. In order to apply section 506(a), the estate must have an interest in the property. The estate has no interest in, and does not administer, abandoned property. In *In re Maitland*, the court stated:

> The difficulty this section presents is that § 506(a) seems limited in its application to "property in which the estate has an interest," and it is clear that if the property never has been property of the estate or if property has been abandoned by the trustee as an asset of the estate, the estate does not have an interest which would allow for a § 506(a) determination.

61 Bankr. 130, 132-33 (Bankr. E.D. Va. 1986). Consequently, debtors cannot void these liens. This assessment is consistent with our examination of statutory language generally. As we have stated, when statutory language is clear, "it is conclusive 'absent a clearly expressed legislative intent to the contrary.'" *Miller v. Commissioner*, 836 F.2d 1274, 1283 (10th Cir. 1988) (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Because abandoned property is not property in which the estate has an interest, section 506(a) does not apply.

In the *Gaglia* case, the Third Circuit rejected this reasoning, concluding:

> If § 506(a) is so interpreted, it would seem to conflict with the plain meaning of § 506(d). Moreover, when a debtor files a Chapter 7 petition, all of his right and title to property, legal as well as equitable, passes to the estate. This includes the legal title to property secured by a mortgage. Thus, even though the Gaglias had no equity in the property, the estate had an interest in it.

889 F.2d at 1308 (citations and footnote omitted).

We reject this approach for two reasons. First, we reject the notion that section 506(d) must be read in isolation. It is a fundamental precept of statutory construction that "[i]n expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Mastro Plastics Corp. v. NLRB*, 350 U.S. 270, 285 (1956) (quoting *United States v. Boisdore's Heirs*, 8 How. 113, 121 (1850)).

Second, the Third Circuit's rationale does not adequately recognize the affect of abandonment with its resulting consequences, including reversion of the property to pre-bankruptcy status. The reasoning in *Gaglia* might apply if the language in the statute was "property of the estate" rather than "property in which the estate has an interest." It is true that pursuant to 11 U.S.C. § 541, all property in which the debtor has a legal or equitable interest becomes part of the bankruptcy case at the time a petition is filed. *See In re Harvey*, 3 Bankr. 608, 609 (Bankr. M.D. Fla. 1980). In this case, however, the operative phrase is "interest of the estate." Following abandonment, the estate no longer has an interest, even though

it did at one time. To construe this section otherwise would defeat the purpose behind the abandonment provision and run counter to the plain language of the Code.

In keeping with this analysis, we join those courts which have concluded that the language used in sections 506(a) and (d) was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code. In *Shrum*, the court provides a cogent analysis of the intended purpose of section 506(a). It states:

> It is common in Chapter 12 and 13 cases for debtors to propose plans which deal with and affect abandoned and/or exempted property, such as real property occupied as the homestead and motor vehicles intended for personal use. In such cases, even though the property may no longer be "property of the estate", it nevertheless remains "property in which the estate has an interest." Plan proponents in Chapter 12 and 13 cases, and, if applicable, in Chapter 11 cases as well, must therefore be permitted to employ § 506(a) in conjunction with the proposed impairment or modification of the rights of the holders of secured claims . . . . Congress has provided numerous incentives to debtors choosing reorganization or rehabilitation under Chapters 11, 12 or 13, rather than liquidation under Chapter 7. It is believed that the availability of § 506 in connection with plans under those chapters which deal with exempt or abandoned property is simply another such incentive.

98 Bankr. at 1001. The plain language of the statute, coupled with the abandonment provision of the code, indicate Congress did not intend to allow Chapter 7 debtors to use section 506(d) to retain abandoned property.

Our assessment that 506(d) does not apply to debtors' property is bolstered further through review of the creditors rights provisions found in Chapters 12 and 13. Pursuant to 11 U.S.C. § 1322(B)(2), a Chapter 13 plan may

not modify the rights of secured claim holders where the claim is secured only by a security interest in real property which is the debtor's primary residence. Likewise, in 11 U.S.C. § 1111(b)(2), the Code allows creditors in a Chapter 11 case to make an election which would result in allowing a secured lien to remain on the property to the full extent of the original obligation.

Reconciliation of these provisions with the language of section 506 mandates the result which we reach in this case. Congress has manifested a strong preference for reorganization rather than liquidation in the bankruptcy setting. *See Maitland*, 61 Bankr. at 135 (recent revisions to the Bankruptcy Code evidence Congress' intent to "steer debtors who are eligible for Chapter 13 away from Chapter 7"). It is inconsistent with this preference to allow debtors more in a liquidation than they would receive in a reorganization.

11 U.S.C. § 722, the Code's redemption provision, is also instructive. It states:

> § 722. *Redemption*
>
> An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

This section constitutes the only redemption provision provided for Chapter 7 debtors. Notably, it only pertains to personal property. In *Maitland*, the court correctly identified the problem when it stated: "In light of the exclusion of real property in § 722, and its express limitation to specific tangible personal property, it is obvious that Con-

gress did not intend to permit a debtor to redeem his real property through the use of § 506(d)." 61 Bankr. at 135.

Here, debtors seek to do exactly what section 722 provides, except with respect to real property. In *Gaglia*, the court correctly noted that section 506 is not a redemption provision. 889 F.2d at 1310. However, the rationale of that case mandates that it become one. The *Gaglia* court distinguished section 506 from section 722 by stating, "the Gaglias will not own the property unencumbered. They will still be subject to First Federal's mortgage and the SBA's claim to the extent it is secured. . . . We do not believe any arguable redundancy in §§ 506 and 722 precludes the application of § 506 here." *Id.* Using the same rationale that *Gaglia* and its progeny embrace, debtors here would own their property outright.[3] Under these circumstances, section 506 *would* be used as a redemption provision. This result is both inequitable and unfair and would constitute an expansion of debtors rights far beyond what is contemplated in the Code.

Those courts allowing avoidance have generally dismissed this fairness argument by assuming that avoidance merely duplicates what would transpire in a liquidation. *See Gaglia*, 889 F.2d at 1308. This assumption overlooks those situations where creditors can use an appreciation in land values to offset their losses at a forced sale following foreclosure.

Outside the bankruptcy setting, it is highly unlikely that a debtor would retain his property in the circumstances presented here. Rather, creditors would probably foreclose and prompt a forced sale. At that sale, a senior lienholder could purchase the property and sell it at some later time in anticipation of a change in land values. If there were two or more claims or mortgages, the junior lienholder could purchase the property, pay the senior lienholder, then inventory the property for later sale in hope of decreasing the amount of loss. In today's real estate market, these are very real considerations. Allowing section 506 relief denies creditors these options. The flaw in the majority's position is the assumption that a third party unrelated to the transaction will purchase the property at a forced sale, thus prohibiting lienholders from reaping the benefits of an appreciation in land values. In today's complex real estate markets, this is not a valid assumption.

[3] Our disposition in this case does not alter the availability of any state law remedies which debtors may have.

Allowing lien avoidance under section 506(d), or in this case, complete redemption, gives debtors much more than the "fresh start" to which they are entitled. We do not believe Congress intended such a result when it enacted these Code provisions.

Consequently, the judgment of the United States District Court for the District of Utah is AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

Bankruptcy No. 84C-01746
(Chapter 7)

Adversary No. 87PC-0116

District No. 88C-0841G

LAMAR DEWSNUP, ALETHA DEWSNUP,
Appellants,

vs.

LOUIS L. TIMM, *et al.*,
Respondents.

ORDER AFFIRMING JUDGMENT OF
BANKRUPTCY COURT

[Filed Mar. 16, 1989]

Debtor's appeal of the Memorandum Decision of the United States Bankruptcy Court and subsequent Judgment of Dismissal of their Adversary Proceeding with prejudice by the Honorable Judge Glen E. Clark came on for hearing before this Court on Thursday, March 2, 1989, at the hour of 4:30 p.m.; Debtor/Appellants were represented by their counsel Scott C. Pierce of McKay, Burton & Thurman and Defendants/Respondents were represented by their counsel Michael Z. Hayes of the firm of Mazuran, Verhaaren & Hayes, and the Court having reviewed the record in this proceeding including the Memorandum Decision of Judge Clark and having reviewed the appeal briefs and having heard the oral argument of counsel and being fully advised in the premises and good cause appearing therefore, it is hereby

ORDERED, ADJUDGED AND DECREED as follows:

1. The Judgment of Dismissal, dismissing with prejudice, Debtor's adversary proceeding in this matter is hereby affirmed.

DATED this 15 day of March, 1989.

Copies mailed to cnsl 3/16/89mp:

William Thomas Thurman, Esq.
Michael Z. Hayes, Esq.
Marilyn Weaver, Bankruptcy

/s/ Judge J. Thomas Green, Jr.
JUDGE J. THOMAS GREEN, JR.
U.S. District Court Judge

Approved as to form:

/s/ Scott C. Pierce
SCOTT C. PIERCE
Attorney for Debtor/Appellants

MAILING CERTIFICATE

I hereby certify that I mailed a true and correct copy of the foregoing ORDER AFFIRMING THE JUDGMENT OF THE U.S. BANKRUPTCY COURT by first class mail, postage prepaid, to Scott C. Pierce, attorney for Debtor/Appellants, Suite 1200 Kennecott Building, 10 East South Temple Street, Salt Lake City, Utah 84133, this 6th day of March, 1989.

/s/ Michael Z. Hayes

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH

Bankruptcy Case 84C-01746

Civil Proceeding No. 87PC-0116

IN RE: LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

vs.

LOUIS L. TIMM, *et al.*,
Defendant.

JUDGMENT OF DISMISSAL

Plaintiffs' Adversary Proceeding came on for hearing before the Honorable Glen E. Clark on Thursday, June 25, 1987, at 9:00 o'clock a.m. Plaintiffs were represented by William Thomas Thurman and Scott C. Pierce of McKay, Burton & Thurman, Salt Lake City, Utah. Defendants were represented by Michael Z. Hayes of Mazuran, Verhaaren & Hayes, Salt Lake City, Utah. The Court, after having reviewed the file and having heard testimony from the parties and after having taken the matter under advisement and subsequently filing its published Memorandum Opinion, which is incorporated into this Order by reference, hereby Orders, Adjudges and Decrees as follows:

1. Plaintiffs' Adversary Proceeding is dismissed in its entirety with prejudice;

2. All parties are to bear their own costs.

DATED this 15th day of August, 1988.

/s/ Judge Glen E. Clark
JUDGE GLEN E. CLARK
United States Bankruptcy Court
Chief Judge

MAILING CERTIFICATE

I hereby certify that I mailed a copy of the foregoing Judgment of Dismissal to the following this 17th day of August, 1988.

William Thomas Thurman, Esq.
Scott C. Pierce, Esq.
MCKAY, BURTON & THURMAN
Suite 1200 Kennecott Building
Salt Lake City, Utah 84133

Michael Z. Hayes
MAZURAN, VERHAAREN & HAYES
Parkview Plaza, Suite 260
2180 South 1300 East
Salt Lake City, Utah 84106

Secretary to Judge Clark

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH

Bankruptcy Case No. 84C-01746

Civil Proceeding No. 87PC-0116

IN RE LAMAR DEWSNUP and ALETHA DEWSNUP,
Debtors.

LAMAR DEWSNUP and ALETHA DEWSNUP,
Plaintiffs,

v.

LOUIS L. TIMM, *et al.*,
Defendants.

MEMORANDUM OPINION

Appearances: William Thomas Thurman and Scott C. Pierce of McKay, Burton & Thurman, Salt Lake City, Utah, for the Plaintiffs. Michael Z. Hayes of Mazuran, Verhaaren & Hayes, Salt Lake City, Utah, for the Defendants.

This is an action to determine the validity and extent of a trust deed on real property. The Plaintiffs' amended complaint alleges that "[t]he security interests of the Defendants can be satisfied in full by Plaintiffs remitting to the Defendants the fair market value of the property upon which the security interest attaches." At the time of trial of this matter, the Court valued the real property subject to the Defendants' security interest at $39,000.00. The Court then took the matter under advisement for the sole purpose of resolving the issue of whether the debtors in this Chapter 7 case may "redeem" real property, which has been or may be abandoned to

them,[1] by paying to the secured creditors the fair market value of the property.

The debtors argue that pursuant to 506(d) of the Bankruptcy Code, a lien is void to the extent it does not secure an "allowed secured claim." Since an "allowed secured claim" is limited to the value of the collateral pursuant to § 506(a), then they should be allowed to simply pay to the Defendants the value of the real property and take the property free and clear of any security interest which the Defendants might assert.

The Defendants, on the other hand, argue that to allow the debtors to redeem real property under § 506(d)

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[1] There is no evidence before the Court as to whether this real property has been abandoned to the debtors or whether the trustee intends to do so. However, this adversary proceeding only states a cause of action if the property is abandoned. Otherwise, the debtors would have no standing to assert their claim to avoidance and redemption and the property would be liquidated by the Chapter 7 trustee, making these matters moot. Although some courts have allowed Chapter 7 debtors to avoid liens pursuant to § 506(d) even though the property had not been abandoned to them, *see, e.g., In re Crouch*, 76 B.R. 91 (Bkrtcy. W.D. Va. 1987), in this case the debtors ask the Court to authorize them to pay the fair market value of the property to the secured creditor and then take title to the property free and clear of liens. That request can only make analytical sense in conjunction with an abandonment from the trustee, either pursuant to § 554(a) or (b) (upon the filing and granting of an appropriate motion for abandonment), or as a result of the operation of § 554(c) (deeming property "not otherwise administered" to be abandoned at the time of the closing of the case). Although the debtors have claimed a homestead exemption in the Oak City property, it is clear from this proceeding that they have no interest in the property by virtue of that claim since there is no equity to which the exemption might attach. *See, Wilson v. General Motors Acceptance Corporation (In re McCoy)*, 643 F.2d 684 (10th Cir. 1981); *Styler v. Local Loan Financial Services (In re Lanctot)*, 6 B.R. 576 (Bkrtcy. D. Utah 1980). Moreover, the trustee of this estate has neither been made a party to this action, nor has he been served with any of the pleadings. Therefore, for the purpose of this opinion, the Court will assume that the real property has been or will be abandoned to the debtors.

would make § 722 (which deals specifically with redemption in Chapter 7 cases) a superfluous provision. They contend that although the provisions of § 506 apply generally in Chapter 7 cases, *see*, § 103(a), principles of statutory construction dictate that the more specific provision (here § 722) should take priority over the general Chapter 5 provision.

Section 506 provides in pertinent part:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.
>
> * * * *
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless—
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Section 722 provides:

> An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.

Courts which have considered the interplay between these provisions of the Code are divided on the issue of whether a Chapter 7 debtor may utilize § 506(d) to avoid the undersecured portion of a lien on real property which has or will be abandoned to it and whether such a debtor may pay a secured creditor the fair market value of such real property in full satisfaction of the lien. The leading case allowing such avoidance pursuant to § 506(d) is *In re Tanner*, 14 B.R. 933 (Bkrtcy. N.D. Penn. 1981). *See also, In re Walker*, 11 B.R. 43 (Bkrtcy. N.D. Ill. 1981); *In re Brace*, 33 B.R. 91, 93-94 (Bkrtcy. S.D. Ohio 1983); *In re Bracken*, 35 B.R. 84 (Bkrtcy. E.D. Penn. 1983); *In re Gibbs*, 44 B.R. 475, 478-479 (Bkrtcy. D. Minn. 1984); *In re Lyons*, 46 B.R. 604 (Bkrtcy. N.D. Ill. 1985); *In re Cleveringa*, 52 B.R. 56 (Bkrtcy. N.D. Iowa 1985); *In re Lindsey*, 64 B.R. 19 (Bkrtcy. C.D. Ill. 1986); *In re Worrell*, 67 B.R. 16 (C.D. Ill. 1986); *In re O'Leary*, 75 B.R. 881 (Bkrtcy. D. Oregon 1987); *In re Gaglia*, 76 B.R. 82 (Bkrtcy. W.D. Penn. 1987); and *In re Crouch*, 76 B.R. 91 (Bkrtcy. W.D. Va. 1987).

In *Tanner*, the debtor had filed an action requesting the court to declare a third mortgage unsecured and, therefore, void under § 506. The defendant argued that Congress did not intend real property mortgages to be voidable and that "lien" as used in § 506(d) does not refer to a lien of a mortgage on real property. In rejecting that argument, the court recognized the broad definition of "lien" under § 101, and stated:

> It is unlikely that Congress would define a lien broadly and then use the word in a narrower sense without so indicating. Further indications of Congressional intent that a real property mortgage is included within the meaning of lien in Section 506(d) are apparent from language elsewhere in the Code. . . . [Specific] terms are used throughout the Code indicating Congress knew how to designate subspecies

> of lien when it is so desired. In addition, Congress has demonstrated that when it desired to single out a real property mortgage for special treatment, it will clearly so indicate. An example is Section 1322 (b) (2) [.]

14 B.R. at 935. Moreover, the court reasoned that § 506 (d) must be construed "in light of the definitional section, Section 506 in its entirety, and the overall scheme of the Code . . . ." *Id.* at 936. In so analyzing the applicable provisions the court concluded that if the undersecured portion of a real property mortgage is not avoidable, a prepetition creditor will impair the debtor's fresh start by partaking in his postpetition property acquisitions, which here includes the postpetition appreciation of real property.

Finally, the court concluded that the bankruptcy procedure was designed to put the debtor and its creditors in the same position they would be if the property had been sold at a non-bankruptcy forced sale on the petition date:

> At a forced sale the Debtor does not retain title to the property and the overvalued lien holder would not gain from future appreciation or increases in the equity. The Defendant's argument requires attributing to Congress an intent to benefit the real property mortgage holder more under a bankruptcy proceeding than under a non-bankruptcy forced sale. Clearly that is not consistent with the intent of Congress in providing for Debtor "relief" under the Bankruptcy Code.

14 B.R. at 937.

The leading cases which have rejected *Tanner* and its progeny and have refused to allow Chapter 7 debtors to avoid the undersecured liens on abandoned real property are *In re Mahaner*, 34 B.R. 308 (Bkrtcy. W.D. N.Y. 1983) and *In re Maitland*, 61 B.R. 130 (Bkrtcy. E.D. Va. 1986). *See also, In re Cordes*, 37 B.R. 582 (Bkrtcy. C.D.

Calif. 1984); *In re Gaglia*, 76 B.R. 82 (Bkrtcy. W.D. Penn. 1987); *In re Smith*, 79 B.R. 650 (Bkrtcy. D. Md. 1987). In addition, certain of the courts which have felt compelled by their reading of the language of § 506(d) to follow *Tanner* have expressed serious reservations about the result. *See, In re Lyons*, 46 B.R. 604, 606-607 (Bkrtcy. N.D. Ill. 1985) ("This problem is a difficult one from a policy perspective because of the apparent divergence here between the law and one's sense of what is equitable. On the one hand, as other courts have noted, the relevant question is what the lienholders' interests would be outside bankruptcy. That is, what each lienholder would receive in a foreclosure should also be the worth of his lien in the bankruptcy setting. On the other hand, it seems manifestly unfair to permit a debtor to retain his house after avoiding liens to the extent they exceed the value of the collateral. As of this time, however, that result seems to be the one which the Code compels."); *In re Worrell*, 67 B.R. 16, 20 (C.D. Ill. 1986) ("Even though the Court is holding that a Chapter 7 debtor may use § 506(d) to avoid the operation of real estate mortgage lien upon his property to the extent that the lien exceeds the value of the property, the Court finds this result unfair and difficult to accept. As the Court said in *Lyons*, '[I]t seems manifestly unfair to permit a debtor to retain his house after avoiding liens to the extent they exceed the value of the collateral.' 46 B.R. at 606-07. This is a difficult problem from a policy perspective because of the Court's sense of what is right and equitable. Nevertheless, the bottom line is that this is a question which Congress should address because the Court cannot rewrite this section of the Bankruptcy Code, and the result reached today appears to be the one which the Code compels.").

In *In re Mahaner*, an undersecured junior mortgage holder moved the court for relief from the automatic stay. In response, the debtors filed a motion under § 506 for a valuation of the real property and indicated their

intention to redeem the property by paying the creditor the amount of its interest in the property. In rejecting the debtor's theory, the court articulated three reasons why § 506(d) may not be used by the debtor to avoid a mortgage lien in a Chapter 7 case: "First, it would appear that to permit lien avoidance . . . would render 11 U.S.C. § 722 totally surplus. . . . A fundamental rule of statutory construction is that a specific statute prevails over an ambiguous or even an inconsistent general statute." 34 B.R. at 309. Second, the court observed that it is not good policy to allow a debtor to get in Chapter 7 more than he could in Chapter 11 or 13. In Chapter 13, § 1322(b)(2) prohibits the debtor from modifying a lien on real property if the property is his principal residence. In Chapter 11, the creditor would be able to make an election pursuant to § 1111(b) to be treated as though he were fully secured, thereby protecting his interest in the appreciation of the real property. Parenthetically the court noted that in its view the "more likely policy of the void language of 11 U.S.C. § 506(d) is that it was intended to permit a sale of the collateral by a trustee or the debtor-in-possession to extinguish the entire lien even though it is at a price insufficient to satisfy the debt in full." *Id.* Third, the court held that such an application of § 506(d) would amount to an unconstitutional taking of a property interest. The court noted that the creditor's right to appreciation in the value of its collateral was a property interest which could not be taken from it without just compensation.

In *In re Maitland*, 61 B.R. 130 (Bkrtcy. E.D. Va. 1986), the debtors commenced an adversary proceeding (1) to determine the extent of allowed secured claims against their real property under § 506(a); and (2) to avoid liens against the property to the extent that liens were undersecured, pursuant to § 506(d). The Court commenced its analysis by noting the relationship and interdependence of § 506(a) and § 506(d):

> The difficulty this section presents is that § 506(a) seems limited in its application to "property in which the estate has an interest," and it is clear that if the property never has been property of the estate or if property has been abandoned by the trustee as an asset of the estate, the estate does not have an interest which would allow for a § 506(a) determination. In contrast, § 506(d) provides that "to the extent that a lien secures a *claim against the debtor* that is not an allowed secured claim, such lien is void. . . ."
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> One must refer to § 506(a) to find that an allowed secured claim is a secured claim only to the extent of the value of such secured creditor's interest in the *estate's interest* in such property.
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> [Section] 506(a) is intended to value claims against property which is going to be administered under the Code, not property abandoned or released.

61 B.R. at 132-133 (emphasis in original). *See also, In re Harvey*, 3 B.R. 608 (Bkrtcy. M.D. Fla. 1980) ("[Section 506(a)] was intended to deal with properties of the estate which are being administered under the Code and not to deal with properties which were released as exempt or abandoned."). The court then concludes that § 506(a) may not be used to bifurcate a claim for § 506(d) purposes when property is abandoned to a Chapter 7 debtor:

> Section 506(a) does not contemplate determining the extent to which a claim is allowed for lien avoidance purposes under § 506(d) if the property has been abandoned. If the property is not to be administered as an asset of the estate for liquidation, or for retention by the debtor-in-possession in a Chapter 11 reorganization or a Chapter 13 wage-earner plan, then determination as to the extent a

> claim is an allowed secured claim serves no statutory purpose, other than as specifically provided under § 722.

Id. at 134. The court also noted that if *Tanner* and its progeny were to be followed, § 722 would be rendered meaningless:

> Section 722, however, does not allow the debtor to redeem *real property* by paying the holder of an allowed claim secured by the abandoned or exempted property the secured amount of the claim. Such a result would occur if the debtor could pay the secured creditor with a lien against the debtor's abandoned or exempted real estate an amount equal to the value of the property and then, under § 506 (d), void the lien to the extent that it is undersecured. In light of the exclusion of real property in § 722, and its express limitation to specific tangible personal property, it is obvious that Congress did not intend to permit a debtor to redeem his real property through the use of § 506(d).

Id. at 135.

As did the courts in *Lyons* and *Worrell*, *supra*, this Court believes the result in *Tanner* to be unfair and inequitable. However, we do not believe, as did those courts, that such a result is compelled by the language of the Code.

To resolve the issues before the Court it is necessary to understand the rights of debtors and their creditors in property which is abandoned under § 554. Section 554 allows a trustee to abandon property which is burdensome to the estate or which is of inconsequential value. When property is properly abandoned by the trustee, the property is no longer property of the estate and the estate, consequently, has no interest in the property. *See*, H.R. Rep. No. 95-595, 95th Cong., 1st Sess., at 343 (1977), U.S. Code Cong. & Admin. News 1978, p. 6299

("property ceases to be property of the estate, such as by sale, abandonment, or exemption."); *In re Cruseturner*, 8 B.R. 581 (Bkrtcy. D. Utah 1981).

In the *Cruseturner* case this Court also examined the rights of the parties vis-a-vis the property following an abandonment:

> The state of the law under the former Act appears to be that title to all property abandoned by the trustee stood as if no bankruptcy had been filed, which in most cases meant it revested in the debtor. Justice Cardozo aptly expressed this rule in *Brown v. O'Keefe*, 300 U.S. 598, 602, 57 S.Ct. 543, 546, 81 L.Ed. 827 (1937):
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> > Whatever title or inchoate interest may have passed to the trustee was extinguished by relation as of the filing of the petition when the trustee informed the court that the shares were burdensome assets, and was directed by the court to abandon and disclaim them. In such case "the title stands as if no assignment had been made." A precise analogy is found in the law of gifts and legacies. Acceptance is presumed, but rejection leaves the title by relation as if the gift had not been made. (Citations omitted.)

In *Wallace v. Lawrence Warehouse Company*, 338 F.2d 329, 394 n. 1 (9th Cir. 1964), the Ninth Circuit emphasized the widespread acceptance of this general position:

> The ordinary rule is that, when a trustee abandons property of the bankrupt, title reverts to the bankrupt, nunc pro tunc, so that he is treated as having owned it continuously. (Citations omitted).

See also Sessions v. Romadka, 145 U.S. 29, 112 S.Ct. 799, 36 L.Ed. 609 (1892); *Sparhawk v.*

Yerkes, 142 U.S. 1, 12 S.Ct. 104, 35 L.Ed. 915 (1891); *In re Garfinkle*, 577 F.2d 901 (5th Cir. 1978); *In re Ira Haupt & Co.*, 398 F.2d 607 (2d Cir. 1968); *Brookhaven Bank & Trust Co. v. Gwin*, 253 F.2d 17 (5th Cir. 1958); *Colson v. Monteil*, 226 F.2d 614 (8th Cir. 1955); *Rosenblum v. Dingfelder et al.*, 111 F.2d 406 (2d Cir. 1940); *In re Moss et al.*, 21 F.Supp. 1019 (E.D. Ill. 1938).

This analysis appears to be equally appropriate to the present law. Section 554 deals with the abandonment of property. Both the House and Senate reports, in explanation of the effect of the section state:

> Abandonment may be to any party with a possessory interest in the property abandoned. In order to aid administration of the case, subsection (b) deems the court to have authorized abandonment of any property that is scheduled under Section 521(1) and that is not administered before the case is closed. That property is deemed abandoned to the debtor.

H.R. Rep. No. 95-595, *supra*, at 377; S.Rep. No. 95-989, *supra* at 92, U.S. Code Cong. & Admin. News 1978, pp. 5878, 6333. Subsection (b), enacted as Section 554(c), was changed in the final draft by deleting references originally made which stated that abandonment under this section would be made specifically to the debtor. Thus, it appears that abandonment under any subsection of 554 will be to a party with a "possessory interest." Generally, a "possessory interest" is defined as a "right to exert control over" or a "right to possess" property "to the exclusion of others." BLACK'S LAW DICTIONARY 1049 (5th ed. 1979). This legislative reference and attendant definition are in keeping with cases under former law which hold that title and right to the property reverts to its pre-bankruptcy status. Thus,

> whoever had the possessory right to the property at the filing of bankruptcy again reacquires that right. Normally this party is the debtor, but it is conceivable that a creditor may be entitled to possession instead if, by the exercise of its contractual or other rights, it held a possessory interest prior to the filing of bankruptcy.
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> *Thus, when the trustee abandons property, the property stands as if no bankruptcy had been filed and the debtor enjoys the same claim to it and interest in it as he held previous to the filing of bankruptcy.*

8 B.R. at 590-591 (emphasis supplied).

The confusion which has arisen over the meaning of § 506(d) is due to the application of the language of that section in isolation from its intended role in the distribution scheme of the Bankruptcy Code. Subchapter I of Chapter 5 of the Code governs the filing, allowance, priority, and distribution of claims of creditors through a bankruptcy proceeding. Section 501 governs the filing of proofs of claims. Section 502(a) provides that a claim will be deemed "allowed" if a proof of claim is properly filed, to which no party in interest objects. If an objection is filed, the Court, based on the provisions of § 502(b), will make a judicial determination whether the claim of the creditor will be "allowed" or "disallowed." Similarly, § 503 governs the allowance of administrative expense claims. The purpose of this procedure is to determine which claims of creditors may participate in the distribution of the estate under a Chapter 7 liquidation or which claims may participate in a plan under Chapters 9, 11, 12, or 13. Creditors are not required to file proofs of claim and debts are discharged whether claims are allowed or not. *See*, § 501(a) and §§ 727(b), 1141(d), 1228(a) and 1328(a). Fi-

nally, general provisions of distribution are set forth in § 507 (priority of distribution) and §§ 509 and 510 (governing subrogation and subordination of certain claims).

In a case under Chapter 7, a trustee is charged with the duty to "collect and reduce to money the property of the estate." § 704(1). Distributions are then made to secured creditors pursuant to § 725, and unsecured creditors pursuant to the priority scheme set forth in §§ 507 and 726. In addition to these provisions, § 522 allows an individual debtor to exempt certain property from the property of the estate and § 554 allows the trustee to abandon property which is burdensome to the estate or that is of inconsequential value. The resulting effect of the latter two provisions in a Chapter 7 case is to exclude certain property from the liquidation and distribution process. It is within this scheme of allowance and distribution that § 506(a) provides that "[a]n allowed claim of a creditor secured by a lien on property *in which the estate has an interest* . . . is a secured claim to the extent of the value of such creditor's interest *in the estate's interest in such property*, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." (Emphasis supplied). To facilitate the distribution and participation in the bankruptcy process, the Code splits an allowed claim secured by property of the estate into a secured portion, which is denominated as an "allowed secured claim," and unsecured portion which will be treated as an "allowed unsecured claim." By definition, a creditor may only possess an allowed secured claim if it has a lien on property of the estate and it is an allowed secured claim only to the extent of the value of that interest.

The purpose of this provision, in the Court's view, is to limit the preferential position of a secured creditor in bankruptcy to the extent to which such a creditor

would be able to look to its collateral for satisfaction of its debt. Only holders of allowed secured claims are entitled to reject a plan and be protected under cramdown provisions of Chapters 12 or 13. Holders of allowed secured claims in Chapter 11 cases are entitled to retain their liens and receive cash payments under the plan having a present value equal to the value of their interest in the collateral, or to otherwise realize "the indubitable equivalent" of their secured claim. *See*, §§1126(a), 1129(b)(2)(A), 1225(a)(5), 1325(a)(5). Only creditors with allowed secured claims may make a § 1111(b) election. The proceeds from the liquidation of a Chapter 7 estate are paid first to creditors holding allowed secured claims. § 724(a)(1).

To fully effectuate this dichotomy of the protection and distribution of allowed secured claims and allowed unsecured claims under the Bankruptcy Code, § 506(d) provides that a lien is void if it secures a claim that is not an allowed secured claim. To underscore this statutory scheme, § 551 provides that a lien void under § 506(d) is preserved for the benefit of the estate.

It is inconceivable to this Court that Congress could have intended to create an avoiding power in a Chapter 7 debtor, respecting property which is not to be administered through the bankruptcy process, and which is based on a dichotomy created to facilitate the administration and distribution of the bankruptcy estate.

Since the rights in property which is abandoned remain the same as if no bankruptcy had been filed, *Cruse-turner*, *supra*, it would be illogical to allow the debtors by virtue of § 506(d) to avoid a lien which they could not avoid outside of bankruptcy. Upon abandonment, the debtor must bear the burdens as well as the rights which it previously possessed. In *Tanner*, Judge Cosetti acknowledges that pre-bankruptcy law is the appropriate paradigm to apply in abandonment cases. He reasons:

> The Code scheme of Section 506 is that creditors receive through the valuation procedure of the Bankruptcy Court the same property value that they would receive through a non-bankruptcy forced sale of the Debtor's non-exempt assets as of the petition date. . . . The operation of Section 506(d) merely effectuates the market place.

14 B.R. at 936-937. However, to concentrate exclusively on the debtor's fresh start, as did the *Tanner* court, at the expense of the property rights of creditors is a misguided approach. At a forced sale of real property, the debtors would not retain title to the property as would the debtors here, unless they were to purchase at the sale. If the secured creditor or a third party were to purchase, any appreciation in the value of the property would inure to the benefit of that party and not to the debtors. Moreover, since the timing of a trustee's sale is in the control of the secured creditor, an undersecured creditor can, if it so chooses, defer sale of the property until it has realized any possible benefit from appreciation. In addition, the ~~secured~~ creditor could simply bid in the amount of its debt at the sale and thereby control the amount of the sales price as well as the timing of the sale. Therefore, even if the debtors were willing and able to purchase at a forced sale, as these debtors now claim to be, they could not compel such a result on an objecting secured creditor, since the timing of the sale and the amount of sales price is in the latter's control. Finally, pursuant to this Court's analysis, if the debtors have such remedies under Utah state law, they may now employ them. However, we conclude that § 506(d) does not grant any additional rights to the debtors in abandoned property than they would have had under prepetition nonbankruptcy law.

The approach suggested by the Court does not impede the debtors' fresh start. They can give up their interest in the property and obtain their fresh start. Moreover,

any deficiency claim is clearly within the scope of the debtors' discharge. However, in this case the debtors are attempting to get more than a fresh start. The debtors want to keep their property and be entitled to the future appreciation in the value of the real property without paying the full amount of the obligation secured by the lien. That is something to which they would not be entitled at a forced sale of the property. Absent abandonment, it is also something they would not be entitled to in a bankruptcy proceeding. Pursuant to § 551, any interest or value arising out of an avoidance under § 506(d) would be preserved for the benefit of the estate and creditors with claims against it.

CONCLUSION

For the reasons set forth herein, the Court holds that a Chapter 7 debtor may not utilize § 506(d) to avoid the undersecured portion of a lien on property which is exempt or which has or will be abandoned by the trustee. The avoiding power of that section is limited to property which is property of the estate and is administered by the trustee.

DATED this 15 day of June, 1988.

BY THE COURT:

/s/ Glen E. Clark
GLEN E. CLARK
Chief Judge
United States Bankruptcy Court

CERTIFICATE OF MAILING

I hereby certify that I mailed a copy of the foregoing Memorandum Opinion to the following this 16 day of June, 1988.

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